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## CABINET AFFAIRS STAFFING MEMORANDUM

Date: 9/11/84 Number: 169065CA Due By:

Subject: Cabinet Council on Economic Affairs Planning Meeting - September 13

8:45 A.M. - Roosevelt Room

TOPICS: Tax-Exempt Public Housing Notes  
Federal Credit Policy

ALL CABINET MEMBERS	Action	FYI		Action	FYI
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Attorney General	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Baker	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Deaver	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Labor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Darman (For WH Staffing)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HHS	<input type="checkbox"/>	<input checked="" type="checkbox"/>	McFarlane	<input type="checkbox"/>	<input checked="" type="checkbox"/>
HUD	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Svahn	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Chapman	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Energy	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Education	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Counsellor	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
UN	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
USTR	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
GSA	<input type="checkbox"/>	<input type="checkbox"/>	Executive Secretary for:		
EPA	<input type="checkbox"/>	<input type="checkbox"/>	CCCT	<input checked="" type="checkbox"/>	<input type="checkbox"/>
NASA	<input type="checkbox"/>	<input type="checkbox"/>	CCEA	<input type="checkbox"/>	<input type="checkbox"/>
OPM	<input type="checkbox"/>	<input type="checkbox"/>	CCFA	<input type="checkbox"/>	<input type="checkbox"/>
VA	<input type="checkbox"/>	<input type="checkbox"/>	CCHR	<input type="checkbox"/>	<input type="checkbox"/>
SBA	<input type="checkbox"/>	<input type="checkbox"/>	CCLP	<input type="checkbox"/>	<input type="checkbox"/>
			CCMA	<input type="checkbox"/>	<input type="checkbox"/>
			CCNRE	<input type="checkbox"/>	<input type="checkbox"/>

## REMARKS:

There will be a Cabinet Council on Economic Affairs Planning meeting on Thursday, September 13, 1984, at 8:45 A.M., in the Roosevelt Room.

The agenda and background papers are attached.

## RETURN TO:

☐ Craig L. Fuller  
Assistant to the President  
for Cabinet Affairs  
456-2823 (White House)

☐ Don Clarey ☒ Tom Gibson ☐ Larry Herbolsheimer  
Associate Director  
Office of Cabinet Affairs  
456-2800 (Room 129, OEOB)

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**THE WHITE HOUSE**

**WASHINGTON**

**September 11, 1984**

**MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS**

**FROM:** ROGER B. PORTER *RBP*

**SUBJECT:** Agenda and Papers for the September 13 Meeting

The agenda and papers for the September 13 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The Council will consider two agenda items. The first is federally guaranteed tax-exempt public housing notes. A memorandum from Greg Ballentine on this issue with a recommendation to convert the tax exempt public housing authority notes into taxable notes is attached.

The second agenda item concerns the scope of the activities of federally-sponsored agencies. The Student Loan Marketing Association (Sallie Mae) has requested Administration support for their purchase and operation of a bank in North Carolina. In responding to this request, it raises the larger issue of the scope of the activities of federally-sponsored agencies. A short memorandum from Greg Ballentine providing background for this discussion is also attached.

**Attachments**

**THE WHITE HOUSE**  
**WASHINGTON**

**CABINET COUNCIL ON ECONOMIC AFFAIRS**

**September 13, 1984**

**8:45 a.m.**

**Roosevelt Room**

**AGENDA**


1. Federally Guaranteed Tax-Exempt Public  
Housing Notes (CM # 493)
2. Federal Credit Policy: Scope of Activities  
of Federal Sponsored Agencies (CM # 494)



**EXECUTIVE OFFICE OF THE PRESIDENT**  
**OFFICE OF MANAGEMENT AND BUDGET**  
WASHINGTON, D.C. 20503

September 11, 1984

**MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS**

**From:** J. Gregory Ballentine   
**Subject:** Federally Guaranteed Tax-Exempt Public Housing Notes

HUD contracts to pay the debt service on certain tax-exempt Public Housing Authority (PHA) notes. Those notes are, therefore, a clear example of federally guaranteed tax-exempt securities.

Consistent with a long standing CCEA position and with the newly issued credit policy circular A-70, the Administration has attempted to convert these bonds into taxable bonds financed through the FFB. This position has, however, been effectively opposed by Congress.

Prior to passage of the Deficit Reduction Act (DRA), the PHA notes were tax-exempt under the Housing Act of 1937. The DRA caused PHA notes to be tax-exempt under the general tax-exempt bond provisions of the Internal Revenue Code. As a result, the Authorities that issue the notes must meet various requirements for tax-exempt bonds, including, in particular, the arbitrage rules.

Normally, the issuer of the tax-exempt bonds receives bond counsel opinion that the various rules are met and that the bonds are, indeed, tax-exempt. This is not practical for PHA notes since there are many small authorities with small issues in each package of securities brought to market. Without bond counsel opinion, investors are likely to consider the tax-exempt status of PHA notes to be questionable. Due to the uncertainty surrounding the tax-exemption of the PHA notes, HUD has suspended the issuance of new notes to finance new spending or, more importantly, to refinance outstanding notes that are coming due.

The outstanding notes (\$14 billion) are short-term; about \$1 to \$1.5 billion are refinanced each month. When a refinancing issue is cancelled, HUD must make outlays in the amount of the note coming due. The suspension has cost about \$1 billion (on September 4) and will cost about \$1.6 billion on October 2. If refinancing remains suspended, HUD will face additional outlays of about \$12 billion over the next year.

HUD has asked the IRS for a ruling concerning the tax-exempt status of PHA notes. At best the IRS might be able to provide a general ruling about "typical" PHA notes. Such a ruling, however, is not a complete substitute for a bond counsel opinion on a specific note issue. Consequently, even with a ruling it may be difficult to market the notes.

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The more complete response to this situation that HUD and OMB recommend is to treat it as an opportunity to convert the PHA notes into taxable FFB financing. In order to convert the outstanding notes into taxable securities, additional budget authority must be granted to HUD. The additional authority is needed to pay the excess of the taxable rate over the tax-exempt rate. (The additional outlays in 1985, as opposed to budget authority, will be about \$0.75 billion.) Given the outlay consequences of inaction, Hill staff have been more amenable than in the past to this change.

Recommendation: HUD and OMB should work with the Hill to seek the additional Budget Authority and law changes to convert the tax exempt PHA notes into taxable notes. This will be a major step toward removing federally-guaranteed tax-exempt securities from the marketplace.



**EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503**

**September 11, 1984**

**MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS**

**FROM: J. Gregory Ballentine** *JGB*

**SUBJECT: The Scope of the Activities of Federally-sponsored Agencies**

SLMA has requested Administration support for their purchase and operation of a bank in North Carolina. Senator Stafford will offer an amendment to the Senate Banking Deregulation Bill (S. 2851) to force SLMA to divest itself of the bank (the bank was purchased a few months ago).

SLMA, like FNMA, is a Federally-sponsored agency that seeks to maximize the profits of its stockholders. In asking for Administration support, SLMA made it clear that their goals in buying a bank are to increase their profitability and to meet their mandate to support education loans. It should be expected that such entities will attempt to exploit their ties to the Federal government to increase their profitability. This general phenomenon was discussed at a previous CCEA meeting.

The principal advantage to SLMA of owning a bank is that they could then invest in tax-exempt student loan bonds without incurring penalties. In general, firms cannot borrow money to buy or hold tax-exempt securities. The penalty for doing so is that the interest on the borrowed funds becomes non-deductible. Banks are largely exempt from this restriction. Thus, they can hold tax-exempt securities even though they are highly leveraged.

Since SLMA is not a bank and is highly leveraged, if they hold tax exempt bonds in excess of 2% of their portfolio, they will lose some interest deductions. By buying a bank and holding tax-exempt securities in the bank, SLMA can avoid the general restriction on borrowing to hold such securities.

SLMA has made it clear to the Hill and the Administration that they do not intend to enter into the normal banking business. Their charter restricts such activity now, but they have offered to accept a restatement of that restriction in law now.

SLMA has stated, however, that they will use the bank to make direct loans to students and faculty. (They are barred from making Federally-guaranteed student loans directly, so the loans to students will be to those not qualified for guaranteed loans.) Making direct loans to students and faculty involves a considerable expansion of SLMA activity, but is allowed by law now. The bank provides a convenient retail outlet for them to make such loans.

In response to charges that SLMA intends to purchase more banks, SLMA has offered an amendment to Senator Stafford that would allow them to own this bank, but would bar them, and other Federally-sponsored agencies, from owning other private financial institutions.